

COMMENT / By Paul S. Nadler

Plenty of Blame to Go Around For the Real Estate Collapse

Looking at the collapse in home prices and commercial construction and the impact on the value of bank mortgage loans for all kinds of real estate, I cannot help thinking of the man who trained his horse to live without food only to find to that just when the beast was getting the hang of it, it died.

That's pretty much what happened in home finance.

First, the regulators became extremely strict in evaluating the worth of loans for homes, shopping centers, office buildings, and the like. Then, the banks and thrifts curbed lending drastically to satisfy the regulators. That restraint has so curtailed real estate finance that prices have declined and the fears of the regulators have been realized.

In sum, the horse died.

Problem's Roots Go Deep

But to be fair, while much of the blame today is being placed on the regulators and lawmakers for being too strict on mortgage loans after a decade of being too lenient, the roots of the mort-

Mr. Nadler is a contributing editor of the *American Banker* and professor of finance at the Rutgers University Graduate School of Management.

gage market collapse go deeper. What are some of these roots?

- First, we must recognize that we are now paying for a decade of overbuilding of all types caused by a sympathetic Congress that wanted money readily available for housing in good years and bad, whether it was needed or not.

This was the basis for the legislative and regulatory favoritism that the thrifts experienced all through the 1980s. And it is the reason the commercial bankers complained they could not get a "level playing field" in the competition for funds. As money flooded into the thrifts, they lent it out, and we overbuilt the nation's real estate stock.

- Second, obsolete laws that keep banks from providing full financing for the public led to the growth of so-called nonbank banks and of foreign institutions' power. This forced U.S. banks to concentrate more resources in areas where they did have the power to operate, notably commercial real estate.

- Third, laws preventing geographic expansion of banks forced them to concentrate lending in their own regions and to forgo the comfort of diversifying geographical risk.



- Fourth, the inability of unit banks to generate large volumes of core deposits led to reliance on volatile purchased funds. This helped cause problems in states like Texas and Oklahoma. And it is ironical that because of unit banking laws intended to protect Texas from outsiders every major Texas bank now is owned by non-Texas interests!

- Fifth, the mania for going public that hit so many mutual thrifts in the 1980s left them with new capital burning holes in their pockets - capital that was put to work financing real estate ventures that otherwise might not have been built.

- And finally, as we try to see why real estate prices have collapsed, we find that much of the decline is merely a return to normal from an era of speculative fever. As prices pushed up, real estate owners felt their property was worth many times what they had paid for it.

When the bubble burst, it was

impossible to recognize that a home was really salable at 80% or less of what we had thought it was worth. Similarly, Texas did beautifully on \$2 oil, superbly on \$35 oil, but then fell on its face with \$18 oil.

Up to this point, one can conclude that it was restrictive laws and promotional legislation that skewed the nation's available funds and led to the overfinancing of construction. This, coupled with the overreaction today, is causing our housing and commercial construction slump, many potential borrowers hold.

But one can look further.

Much of the financing that did take place was based on overoptimistic sales and price estimates. Builders decided that, if the banks would provide all the money, they would provide "sweat equity."

Banks Took Most Losses

The result: Banks that financed projects that turned sour took most of the losses.

On top of this, many homebuyers and other borrowers have hidden under the mantle of personal bankruptcy when their plans went awry.

The result is a far more cautious banking system.

So there are many roots to our housing collapse and the attendant depression for some banks. We cannot place all the blame on regulators. But we can learn the lesson the Soviet Union also is learning: Watch out when you take away allocation of funds from the free market and give it to government officials. □

COMMENT / By Jeffrey R. Weisman

Build Relationships to Win New Middle-Market Clients

Lending officers, by definition, make loans. Now we're asking them to become marketers - to create new business relationships and to sell services.

Many banks offer sales training, but success is slow in coming. The bankers' basic skills are in lending and relationship maintenance. It's difficult for them to unlearn the old habits and adapt to the new selling ways of business.

In the business of getting new business from middle-market companies, one statement by the controller of a \$12 million manufacturing company truly applies:

"Your opportunity to switch a company from one bank to yours only comes once - when his current bank screws up."

Windows of Opportunity

But when will that happen? And how does a bank position itself to be the one called or considered when the opportunity arises? In service businesses such as banking, clients don't run out of the service - as the consumer does with Tide and Crest.

There aren't frequent opportunities to win business. And experience in soliciting new business demonstrates that

companies that appear most anxious to select a new bank are invariably the companies not very desirable as new clients.

Beyond Quarterly Thinking

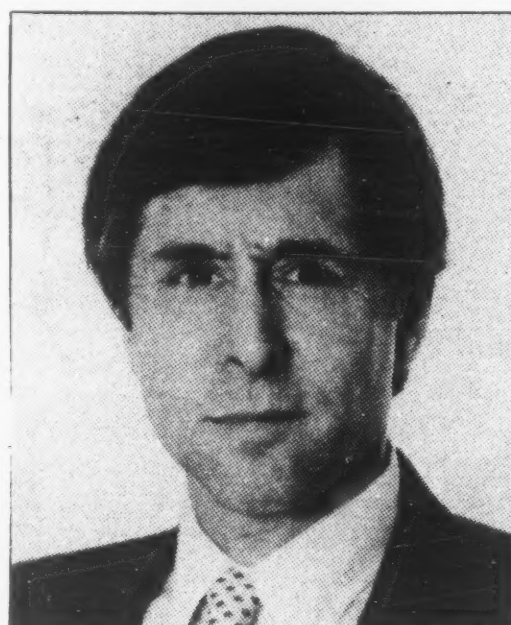
What can a banker do to insure a steady flow of new business? First of all, the bank (and banker) must depart from quarterly thinking to longer-term, sales-cycle thinking. New business is not won after one visit.

It takes eight or 11 or 14 months to land a new client. It requires building a relationship so that when the prospect's current bank "screws up," you and your bank are called as the replacement or to make a proposal.

Quarterly make-the-numbers thinking must be changed. Bankers need the time to develop relationships - and banks need to foster the atmosphere to develop them. This implies a system to measure new business development beyond just accounts signed up.

Give Credit for Activity

In manufacturing companies, work in process is measured or counted. The same can apply in service-company new-business efforts. As a relationship builds, it becomes more of an asset to the bank - since presumably the company will become a client at some point in the near future. Bankers can receive credit for



relationships in process - making initial contact, meeting in-person, developing a first-name relationship with the decision-makers and/or users, maintaining top-of-mind awareness, opening the account, selling additional services.

Relationship-building goals can be applied to each level at the beginning of the year. Moreover, bankers will not become frustrated if a sale is not made - because there will always be prospects at varying stages in the pipeline.

Communications Tools

Bankers need to communicate with prospective customers. They need personalized letters and other sales aids - to make contact, to get in the door, to leave behind, and to keep their name and the bank's name in front of the prospective customer. Bankers should have marketing-communications tools that recognize the value of relationship building. These sales tools should be personalized to the greatest extent possible.

Centralize and Localize

Bankers may be able to write proposals and financial reports

but rarely persuasive business letters. So prepare their marketing communications tools centrally: letters, scripts, leave-behinds, attention getters.

Bankers will randomly uncover leads in their normal course of business, but a formal lead-generation program should be coordinated on a centralized basis. Buying a list, cleaning it, and running it against the bank's customer file is a task for marketing management, not line bankers.

Give the bankers the leads to pursue locally and individually. Besides professionally prepared marketing-communication tools, give them the capability to produce letters at the branch or commercial-center level. In this way, they control their marketing efforts while the identity, image, and professional marketing standards of the bank remain high and consistent.

Decentralizing this part of the process will foster the individual style and success methods of the bankers that are needed to cultivate relationships.

Keep Track of Progress

Bankers can be evaluated from their performance with the leads. Performance evaluation calls for objective measures of relationship building. The sale is not the only thing, since it can take months to accomplish.

Who do leads belong to? In the brokerage business, leads traditionally belong to the brokers. Yet in banking, organized selling and relationship building remain relatively new concepts, so leads conceivably still belong to the bank.

By keeping track of progress, the continuity of contact will be maintained if a banker is reassigned. □

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Mr. Weisman is president of Weisman & Associates, a marketing services company based in New York.

Justice Says Long Arm of Law Reaching More S&L Cases

By BILL ATKINSON

WASHINGTON — Months after Justice Department officials were pilloried by Congress for not working fast enough to throw wayward savings and loan executives in jail, the agency is boasting of bigger and better numbers.

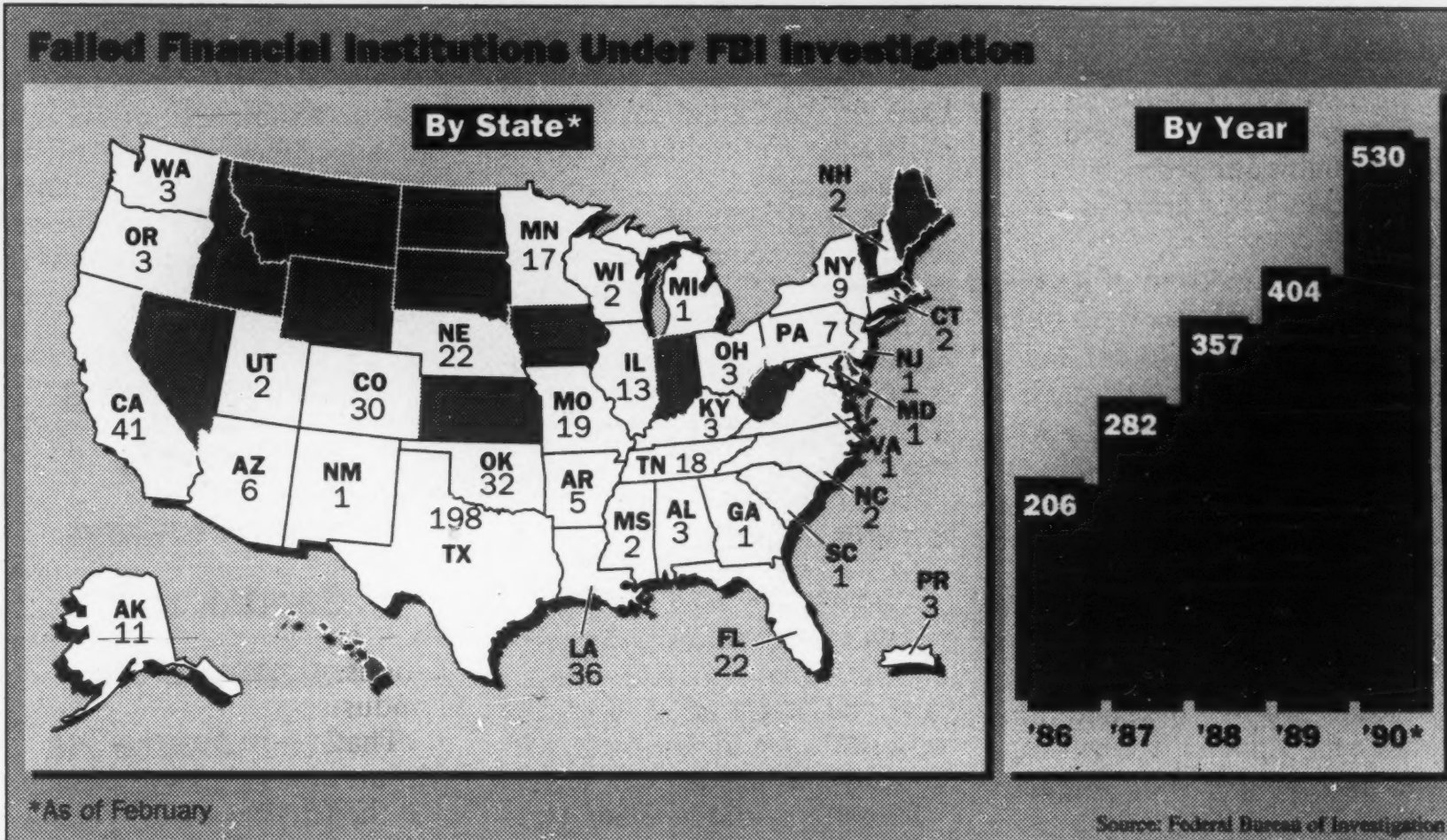
In a study compiled as of July 22 by the department, Justice estimates that 243 S&Ls have been "victimized" since Oct. 1, 1988, and that 328 people have been charged with crimes in thrifts.

In addition, 213 defendants have been convicted, only five have been acquitted, and prison sentences have reached a combined total of 415 years. Fines stand at nearly \$1 million, and judges have ordered the convicted to cough up a total of \$56.6 million in restitution, the study said.

Coordinator Is Upbeat

"The track record of federal investigators and prosecutors in financial-institution fraud investigations and prosecutions is impressive," said James G. Richmond, U.S. Attorney for the Northern District of Indiana and special counsel to coordinate federal enforcement of thrift-related crimes. "We are confident it will even get better in the years ahead."

Mr. Richmond made his comments last week before the Sen-



ate Judiciary Committee in Chicago.

Justice's numbers game comes several months after the agency was criticized by Rep. Doug Barnard, D-Ga., and other members of the House Government Operations subcommittee on commerce, consumer, and monetary affairs. Mr. Barnard complained that the department wasn't doing enough to prosecute crime at failed thrift institutions.

"Are we really trying to bring justice to bear in these criminal cases?" Mr. Barnard asked at the

hearing last March.

In June, President Bush held what amounted to a pep rally for senior federal prosecutors.

He created a federal strike force to catch criminal activity at financial institutions, and said that the agency would "not rest until the cheats, the chisellers, and the charlatans spend a large chunk of their lives behind bars."

Justice aims to carry out the President's mandate. According to the agency, the number of failed financial institutions under investigation by the Federal

Bureau of Investigation jumped 31% to 530 in February, up from 404 at the end of 1989. In 1986, the FBI launched probes into 206 financial institutions.

Lone Star Leader

Texas leads the nation in the number of FBI investigations into failed financial institutions, with a total of 198. It is followed by California with 41 investigations, Louisiana with 36, and Oklahoma with 32 investigations.

Although Mr. Richmond expects to find more evidence of

fraud in the Northeast, as yet the region doesn't boast the Texas-size numbers. New York heads the pack with nine investigations, followed by New Jersey with four and New Hampshire with two.

Defending the Government

The agency has assembled a team of attorneys in the civil division to defend the federal government against suits that challenge certain provisions spelled out in last August's Financial Institutions Reform, Recovery, and Enforcement Act, Mr. Richmond said.

One of the most widely publicized cases challenged the appointment of M. Danny Wall as director of the Office of Thrift Supervision.

"Many other challenges to FIRREA are in litigation, and more are on the way," Mr. Richmond said.

Changed Rules?

For example, plaintiffs in 20 pending actions have charged that new capital requirements under the reform act constitute an abrogation of previous contracts or forbearances the institutions entered into with regulators in 1988.

In those deals the government gave some thrift acquirers tax breaks, yield-maintenance agreements, and notes from the Federal Savings and Loan Insurance Corp. □

THE WEEK ahead

MONDAY, AUGUST 20

The House and Senate are both in recess. The House returns Sept. 5, and the Senate reconvenes Sept. 10.

The Congressional Budget Office releases its latest assessment of the nation's economy and the budget deficit.

The Supreme Court is in recess until Oct. 1.

TUESDAY, AUGUST 21

The Federal Open Market Committee meets to decide whether to alter Federal Reserve Board monetary policy. Most Fed-watchers had expected the FOMC to again let short-term interest rates fall in order to stimulate a flagging economy, but economic data released late last week included a 0.6% increase in core inflation, far stronger than expected, with the prospect of worse to come.

Surging oil prices caused by the Iraqi invasion of Kuwait, and the subsequent boycott of the 4.4 million barrels a day of oil that those countries were producing, will raise the inflation rate to 5.2% for 1990 and reduce economic growth to 1.1% this year and 0.5% in 1991, said Donald Ratajczak, director of the Georgia State University economic forecasting center.

Economists say an easing is still expected but will be postponed by the FOMC until events in the Middle East stabilize and the direction of oil prices becomes clear. 202-452-3000.

The Resolution Trust Corp. board holds an open meeting. Topics include affordable housing rules and revisions of its ethics rules. 202-416-7566.

WEDNESDAY, AUGUST 22

No significant events scheduled.

THURSDAY, AUGUST 23

Durable goods orders and shipments figures for July are to be released by the Commerce Department.

FRIDAY, AUGUST 24

The Federal Reserve Board releases the minutes of the Federal Open Market Committee's July 2-3 meeting, which will show whether it decided to change Fed monetary policy. 202-452-3000.

The first revision of real gross national product figures for the second quarter is to be announced by the Commerce Department.

Preliminary corporate profit figures for the second quarter are to be released by the Commerce Department.

PEOPLE

Wells Fargo Replaces Retiring Lobbyist

The banking subsidiary of Wells Fargo & Co. will replace its retiring lobbyist Jackson Schultz with Craig G. Wolfson on Aug. 31.

Mr. Wolfson, 40, joined the San Francisco bank in April from the banking subsidiary of First Nationwide Financial Corp., also of San Francisco. He had run First Nationwide's government affairs office since September 1988. Before that, he was the thrift's acquisitions manager and, earlier, its corporate counsel. He holds a law degree from the University of Florida.

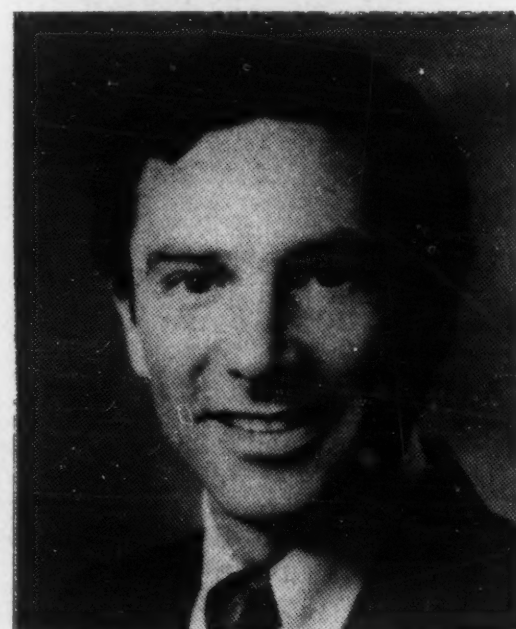
Mr. Schultz is staying with Wells Fargo under a three-year consulting contract for special government affairs projects.

Meanwhile, MNC Financial Inc., Baltimore, let go Marguerite D. Ayers, who had tracked Washington affairs for the \$27 billion-asset banking company.

"Her function was eliminated as part of our consolidation process resulting from the merger with Equitable," said MNC spokesman Daniel G. Finney. "She was released with a severance package a couple of months ago."

Michael C. Middleton, MNC executive vice president, administration, remains top lobbyist.

Mr. Finney denied that MNC is cutting its lobbying effort by dropping Ms. Ayers. "The gov-



Craig G. Wolfson
He'll take over

ernment relations function has always been managed by an executive vice president of the holding company," he said. The company reported a \$74.4 million second-quarter loss last month, as its nonperforming assets ballooned by 111%, to \$757 million.

Gerald L. Jacobs is the Resolution Trust Corp.'s new special counsel, the top legal job at the thrift bailout agency. He replaces Rex R. Veal, who left the RTC Friday to return to private practice with Powell, Goldstein, Frazer & Murphy in Atlanta.

Mr. Jacobs, slated to start work Sept. 1, comes to the RTC from O'Connor, Cavanagh, An-

derson, Westover, Killingsworth & Beshears, a Phoenix-based law firm where he has worked since 1963.

At its open meeting last week, the RTC settled a lingering question about whether the agency's legal operation ought to be separate from the Federal Deposit Insurance Corp.'s legal office. RTC lawyers will continue reporting to the FDIC general counsel, Alfred J.T. Byrne.

Mr. Byrne said in an interview last week that one general counsel makes the most sense because the FDIC and the RTC share boards of directors.

"Gerry Jacobs is an exceptional manager and a superb business and real estate lawyer," Mr. Byrne said. "He is someone I have known and respected for more than a decade."

Mr. Byrne worked with Mr. Jacobs in the late 1970s when the latter represented INA Corp., an insurance company where Mr. Byrne managed investments.

Mr. Jacobs holds a bachelor's degree in economics from Stanford University and a law degree from the University of Arizona.

Mr. Byrne said Mr. Jacobs was lured to the job by its challenge. "We are where the action is," he said.

— Barbara A. Rehm

NY Blackout Prompts Review Of Disaster Plans

By JEANNE HIDA
and KAREN GULLO

When Citicorp's computer problems kept the nation's domestic payment system open till midnight last week, many others felt the repercussions.

Banks paid overtime to employees working almost round the clock, backup generators were strained at the Federal Reserve Bank, and corporate customers reported lag times in receipt of transactions.

An executive of Merrill Lynch & Co., a Citicorp customer, said the brokerage firm could not quantify the impact of the late settlement on Wednesday. But the week-long problems at Citicorp and other major banks because of a power failure cost Merrill "tens of thousands" of dollars in unnecessary overdrafts because it could not accurately assess its positions, he said.

ANALYSIS: Follow-up on the news

Industry experts said Citicorp was caught with its guard down. If it had been using a relatively new form of disaster recovery that copies transactions to a remote site as they occur, it probably would have fared much better. Its funds business would have been disrupted for only a few hours instead of almost a day, they contend.

Remote Vaulting

Manufacturers Hanover Trust Co. and Chemical Bank have had this capability, called remote vaulting, for several months. Neither of those banks' funds transfer operations were affected by the recent blackout, so that ability was not tested.

Ironically, Citicorp was in the process of designing such a system when the power outage occurred, sources close to the bank said.

Industry insiders said that not only was Citicorp lacking in state-of-the-art technology, but it may have handled its operating problems poorly. Citicorp "waited far too long to implement its internal plan, and then it failed," said one disaster recovery expert.

"We're sufficiently concerned [about our disaster recovery plan] that we will do a detailed postmortem and then we'll take action," said Colin Crook, Citicorp's information chief.

"This was a loss of power on a big scale. People tend to focus on defined disaster scenarios. They need to be more flexible."

Sources noted that Citicorp was the only money-center bank

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INSIDE NEWS

FINANCE

IN AN ATTEMPT to extend their funding without paying the high costs of subordinated debt issuance, a growing number of banks are turning to the market for medium-term notes. *Page 16*

AMBASE CORP., parent of Carteret Bancorp, said that an investor group has proposed to buy 50.1% of its common stock. *Page 14*

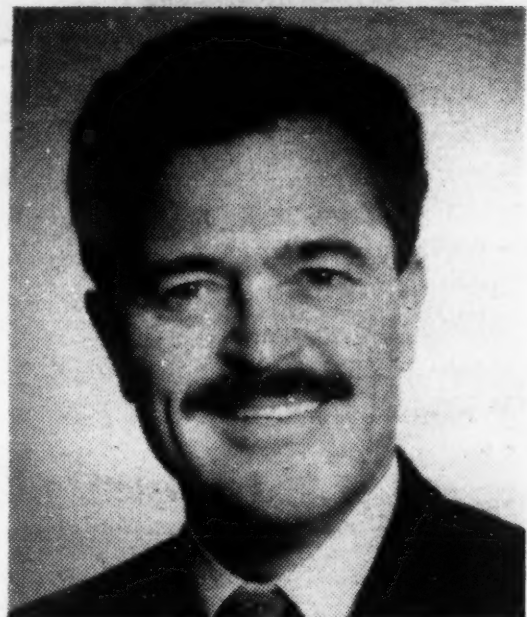
CONSUMER

SMALL-BUSINESS owners do not believe they are victims of a credit crunch, but they do worry about economic trends, a survey shows. *Page 8*

INTERNATIONAL

NATIONAL BANK of Kuwait, the Arab oil state's biggest commercial bank, has shifted much of its top management and activity to London. *Page 9*

MORTGAGES



GEORGE BENDER, formerly of CenTrust, is about to go to bat for Lewis S. Ranieri as his top mortgage banking man. *Page 6*

MERIDIAN'S mortgage unit has dropped a plan to acquire 16 mortgage-origination offices from a subsidiary of Travelers Corp. *Page 2*

TECHNOLOGY

COMPUTERS will remain a top budget priority for bankers, according to an *American Banker* survey. *Page 3*

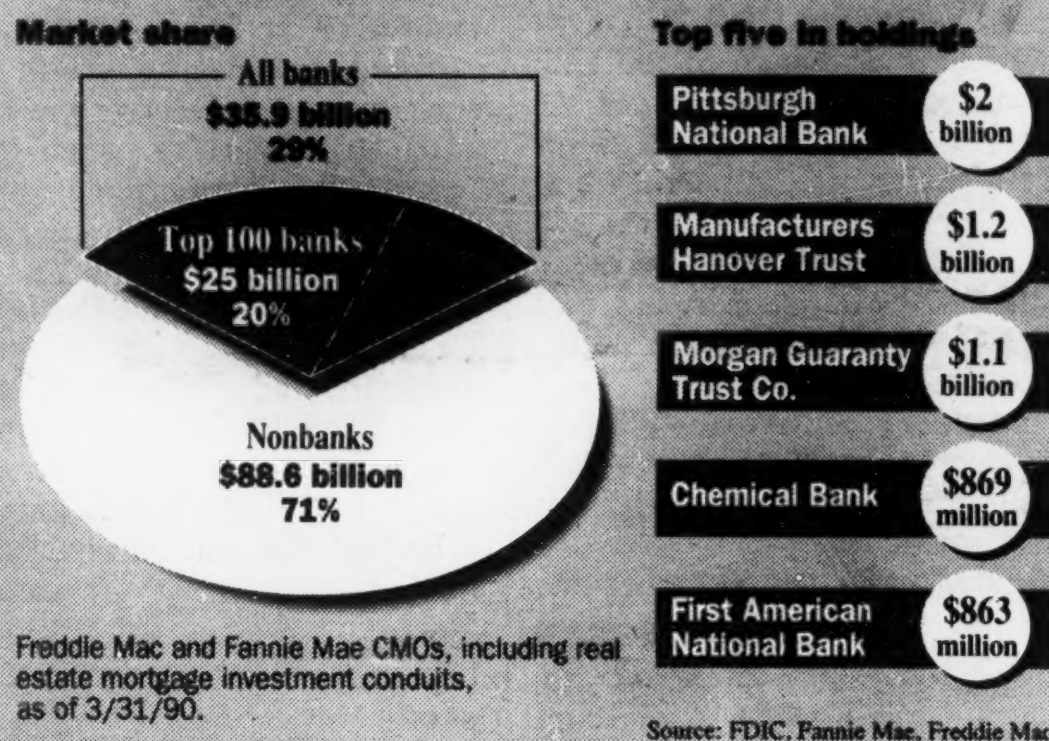
COMMENT

THE NEXT RECESSION may be worse than the last, given the weakened resilience of the U.S. financial system, writes James Grant. *Page 4*

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Banks Take Big Bite of Agency CMO Market



Filings Reveal Banks Hold 30% Of Collateralized Mortgage Bonds

By PHIL ROOSEVELT

As commercial banks stormed into home-mortgage finance over the past year, they appeared to take a special interest in collateralized mortgage obligations, or CMOs. Now, for the first time, regulatory data have specified the extent of that interest.

Led by 100 especially active institutions, the banking industry held about \$36 billion of the most common types of CMOs at the end of March, the data show. (Table appears on page 7.) That position, built almost from scratch at the end of 1988, represented nearly 30% of all such CMOs, and about 6% of all securities held by banks.

Steady Appetite

Bankers and dealers say banks' appetites for instruments

has diminished somewhat in recent months because of declining yields relative to Treasury securities and some regulatory uncertainty.

But the industry's appetite has hardly disappeared. With loan demand declining, banks are closely eyeing securities purchases, and CMOs still yield more than some corporate bonds, experts note.

"We're still seeing a large amount of interest by banks across the board," says Craig Overlander, a senior managing director at Bear Stearns & Co., New York.

Holdings Disclosure

The Federal Deposit Insurance Corp. required banks to disclose their CMO holdings for the first time in call reports for

See DATA page 6

Judge Backs Government In Seizure Of Lincoln

By DEBRA COPE

WASHINGTON — U.S. District Court Judge Stanley Sporkin upheld on Thursday the government's 1989 seizure of Lincoln Savings & Loan Association, accusing Charles H. Keating Jr. and other officials of "looting" it.

The ruling was viewed as a big victory for federal thrift regulators and an endorsement of their procedures for assessing and closing troubled institutions.

Heavy Blow to Keating

It also dealt a major blow to Mr. Keating's campaign to regain control of the Irvine, Calif., savings and loan, which had become symbolic of the costly thrift crisis and bailout.

Judge Sporkin's ruling came after eight months of testimony in which Mr. Keating sought to prove that regulators acted "arbitrarily and capriciously" when they placed Lincoln in receivership in April 1989 and in conservatorship four months later.

Mr. Keating contended that the thrift was actually solvent and regulators carried out a personal vendetta against him.

The judge said Lincoln and its parent, Phoenix-based American Continental Corp., impro-

See OTS next page

Customers Claim NBW Misused Insured Deposits

By BILL ATKINSON

WASHINGTON — Customers of the failed National Bank of Washington have filed more than a dozen lawsuits alleging that the bank illegally used insured deposits and funds intended for low-risk investments to bolster the commercial paper program of its parent company.

The flurry of lawsuits comes just weeks after the holding company, Washington Bancorp., filed for reorganization under Chapter 11 of the federal Bankruptcy Code. Hours after that Aug. 1 filing, federal regulators seized the \$1.6 billion-asset National Bank of Washington and subsequently sold its deposits to Riggs National Corp., Washington.

Unsecured Creditors Unpaid

About 50 unsecured creditors in the banking company were

See CUSTOMERS page 8

Wells Fargo Shares Fall Sharply On Fears of California Real Estate

By GORDON MATTHEWS

NEW YORK — Shares of Wells Fargo & Co., a favorite trading vehicle of many bank stock investors, have tumbled dramatically in value this summer as worries have grown about the U.S. economy and in particular about the real estate market in California.

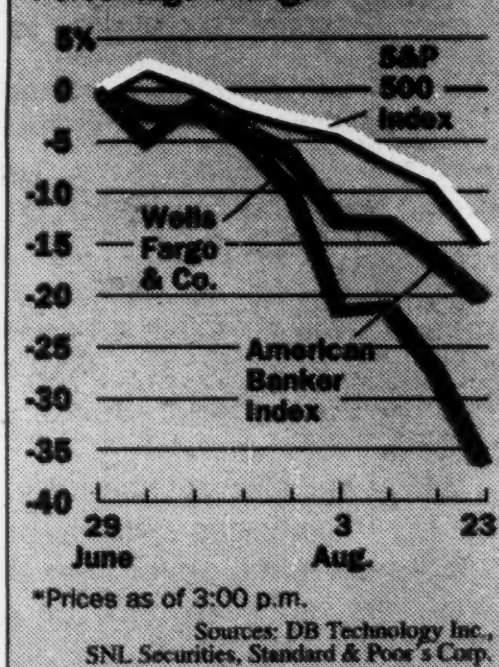
The stock of the well-regarded San Francisco superregional bank closed at \$80.125 on July 17 as it reported strong second quarter profits. That same day the Dow Jones industrial average peaked at 3,024.26, before closing just below the 3,000 mark.

Both have since been in a steep southbound spiral, and bank analysts are mixed about Wells' outlook.

Peaked in Mid-July

Wells' shares fell below book value this week and briefly dipped below the \$50 mark on Thursday, a slump of 38% from the mid-July peak. In the mean-

A Dramatic Slide for Wells Fargo Shares



time, the Dow fell another 40 points to 2,560.15, an 18% decline over the same period in the closely watched blue chip index.

"Wells is a major real estate bank and that is what this is all about," said one analyst, who

See WELLS back page

COMMENT / By James Grant

Banks Now Pay for Years Of Sapping Their Finances

Whatever else it might be, the dust-up in the Middle East is an Exogenous Event – an unexpected disturbance from outside. In boom times, investment bankers assumed that nothing could, or would, intrude on prosperity – every surprise would be a tender offer.

Now that something has gone wrong, the universal finger of blame is pointed at the scene of the disturbance, not at the frail financial structure that was so easily upset by it.

The United States may or may not be more vulnerable to a disruption of its oil imports than it was 17 years ago. It is certainly, we think, more vulnerable to an interruption of its prosperity. Interest rates are higher, financial leverage is greater, and the banking system is more fragile than it was at the time of the first oil jolt.

Citicorp as Exemplar

There are many ways to illustrate the point, but the decline of Citicorp (then as now the largest U.S. banking company) is one of the most vivid and telling.

In 1973, Citicorp was riding high. By the not very exacting standards of today, the bank was profitable, liquid, conservatively capitalized, resilient, and expansion-minded.

Its stock changed hands at a

Mr. Grant is editor of *Grant's Interest Rate Observer*, a biweekly newsletter. This article appeared in the Aug. 17 issue.

premium to book value. Its debt was unrated (there wasn't much debt to rate, in fact) but was destined to be Aaa when Moody's first investigated it, in 1977.

In every particular, 1990 is different – and different, of course, not only for Citicorp but also for big U.S. banks in general. Although it has not been earning its dividend for three years, Citicorp recently raised it.

"Will the next recession resemble that of 1973-75? Insofar as the resilience of the U.S. financial system bears on the question, we are led to believe that it may well be worse."

Its return on average assets last year was a paltry 23 basis points; it earned 63 basis points in 1973.

In 1989, its ratio of loans to deposits was 112%; it was 80% in 1973. In 1989, Citicorp earned 4.3% on equity; in 1973, it earned 15%. As for its senior debt rating, it is no longer Aaa. Moody's judges it to be A3.

In the early 1970s, Citicorp was hot, like inflation. In 1973, when the editors of *Dun's Review* selected it as one of America's five best-managed corporations, its assets grew by 28%. In 1974, a wall-to-wall recession year, assets grew by 32%.

It is fun to reread the bear-baiting letters that Citicorp chairman Walter Wriston wrote to his shareholders in those

days. "It was a good year to remind ourselves that the recuperative powers of the world are enormous and the ability of its three and three-quarter billion people to develop in new ways to handle new situations has always exceeded the imagination of the doomsday prophet," he wrote of 1973.

Brave words! What Mr. Wriston did not commit to paper was the thought that inflation subverts what his predecessors called sound banking – that it undermines asset quality in the long run even as it stimulates asset growth in the short run.

And if that thought did not occur to Mr. Wriston, neither did it seem to worry his successors. Pick up any study of questionable bank lending (real estate,

highly leveraged transactions, loans to lesser-developed countries), and Citicorp is sure to be mentioned early and often.

A Cycle of Wasting

The issue, however, is not a particular class of loan but a process of atrophy. It is a cycle that has involved much of the U.S. banking industry.

The process works like this (thank you, James Robinson): A rise in bad assets is met with a grudging rise in reserves. As reserves increase, earnings decrease. By degree, the decline in creditworthiness forces a rise in the cost of funding: The prices of jumbo certificates of deposit and interbank loans go up.

As the cost of liabilities rises,

interest margins shrink; profits fall again. With every addition to the reserve for bad debts, the problem is exacerbated. Mad-deningly, it costs more to attract deposits for loans that aren't accruing interest income than for loans that are.

The Unfriendly Markets

At length, some loans are written down to zero. Still, everyone sees, the reserve is inadequate to cover the questionable debts that haven't been written down all the way.

Walter Wriston was fond of rebutting the calamity-howlers of his day with a line about the market's creative powers. In our day, banks in general, and his alma mater in particular, are making heavy weather of it in a number of markets.

"American Telephone & Telegraph Co. said its new credit card ranks eighth in the country, with revenue of \$750 million after 140 days in operation," the *Wall Street Journal* reported last week in an article that must have rattled the windows in Citicorp headquarters.

No doubt, the marketplace is evolving a new, deflation-resistant credit structure even now. But for the time being, the deflation of asset values – the very values against which Citicorp and other banks lent so blithely in the boom – proceeds apace.

In 1973, bankers were optimistic, and bank credit was expanding. In 1990, bankers are worried, and bank credit is stagnant – even, in certain regions and markets, contracting. It is a perilous time in which to impose a new tax on oil.

Will the next recession resemble that of 1973-75? Insofar as the resilience of the U.S. financial system bears on the question, we are led to believe that it may well be worse. □

COMMENT / By Masaharu Usuki

From Tokyo, Strong Support For Japanese Deregulation

The following appeared in slightly different form in a June newsletter published by the Long-Term Credit Bank of Japan, Tokyo.

The second meeting of the Japan-U.S. working group on financial markets took place in Tokyo in late May. A statement issued by U.S. Treasury Undersecretary David Mulford after the meeting said the United States appreciated the liberalization of overseas bank account openings by individuals and other Japanese financial deregulation measures but was still dissatisfied with current conditions regarding deregulation of bank deposit rates and foreign firms' access to the Japanese money market.

The U.S. Congress also remains greatly concerned over Japan's financial markets and is even tougher than the Treasury Department in demanding Japan's financial deregulation.

The Congressional concerns

have taken the form of the proposed Fair Trade in Financial Services Act, which passed the Senate Banking Committee. It would enable the Federal Reserve Board and other regulators to disapprove expansion of U.S. operations by foreign financial institutions if the Treasury secretary judges that their countries fail to give U.S. institutions opportunities to fairly compete in their domestic markets.

The primary purpose of the legislation is to pressure Japan into quickening financial deregulation.

Market Share Increasing

Behind the tough U.S. request is the fact that Japanese banks' shares of U.S. and other overseas markets have been persistently increasing. Eight of the 10 largest banks in the world in assets are Japanese.

In 1980, the largest Japanese bank was ranked 10th in the world. But Japanese banks started rapid growth around 1984.

The agreement on new capital adequacy regulations at the Bank for International Settlements in 1988 was designed pri-

marily to hold down the fast expansion of Japanese banks. But the fiscal 1988 asset growth of Japan's city, trust, and long-term credit banks was 16%, exceeding an annual average of 12% for the fiscal 1983-87 period.

In the United States especially, Japanese banks' lending has increased rapidly. They accounted for 16% of commercial and industrial loans in the United States at the end of 1988, being the top foreign lender in that country. Moreover, Japanese banks' outstanding loans there expanded as much as 50% from the end of 1983. In contrast, foreign banks' share of bank loans in Japan is limited to 2% and has been declining.

Competition from EC

Another matter of concern to the United States has emerged in relation to U.S. banks' international competitiveness, namely the European Community's financial market integration scheduled for 1992. Upon integration, an institution given a banking license in any EC country will be able to do business in any other EC nation.

But the EC's second directive on banking allows the EC Commission to decide whether to give a new business license to a foreign bank in view of reciprocity. The decision will depend on whether the home country of the foreign bank guarantees EC banks effective access to its domestic market.

The EC financial market inte-

gration has caused two moves in the United States. One seeks to make the U.S. market as liberal as the EC market, by allowing the mutual encroachment of commercial banks and securities companies onto each others' turf and by permitting interstate banking. Another move introduces the weapon of reciprocity requirement to counter the EC action, and directs it against Japan.

Hastening Deregulation

Some foreign leaders, including Federal Reserve Chairman Alan Greenspan, appreciate Japan's financial deregulation to date. The recent declines in Japanese stocks and the yen are expected to decelerate the expansion of Japanese banks' assets. In this context, efforts to persuade foreigners to understand Japan's realities might ease foreign pressures for Japanese deregulation.

But Japan cannot expect such efforts to have a lasting effect. The world is moving toward prompt deregulation, and this can also improve Japan's economic welfare. Deregulation would serve to intensify competition between financial institutions, helping to improve services and lower costs for fundraising and investment activities of industrial companies and consumers alike.

Needless to say, Japan should make efforts to speed up financial deregulation as much as possible. □

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Mr. Usuki is with the economics division of Long-Term Credit Bank of Japan, Tokyo.

Bank Holdings in Collateralized Mortgage Bonds Disclosed

Continued from page 1

the quarter ended March 31.

CMOs, which flourished after tax-law changes in 1986, are multiclass securities that can provide investors with more payment certainty than basic mortgage-backed securities. Typically backed by basic mortgage securities, CMOs offer short-, intermediate and long-term estimated maturities.

Risks, Returns Vary

CMO classes vary widely in riskiness and potential returns. Michael Grupe, head of mortgage research at Kidder, Peabody & Co., says banks have

"We're still seeing a large amount of interest by banks across the board."

Craig Overlander
Bear Stearns & Co.

tended to concentrate on relatively stable CMO classes with two- or three-year estimated lives, finding them good fits against deposits and other liabilities.

Three-year classes of traditional CMOs now sport yields about 90 basis points higher

than those of comparable Treasury securities, according to Merrill Lynch Mortgage Capital. The push into CMOs comes as commercial banks also have been making major inroads into mortgage originations, mortgage servicing, and investments in basic mortgage-backed securities.

Risk-based capital rules have provided fresh incentives for banks to take on mortgage assets, and the problems in the thrift industry have created some big opportunities for banks.

Move Away from Treasuries

National City Bank, Cleveland, says it increased its CMO position sharply last year as sales of mortgages by insolvent and capital-short thrifts drove up the relative yields on most types of mortgage securities.

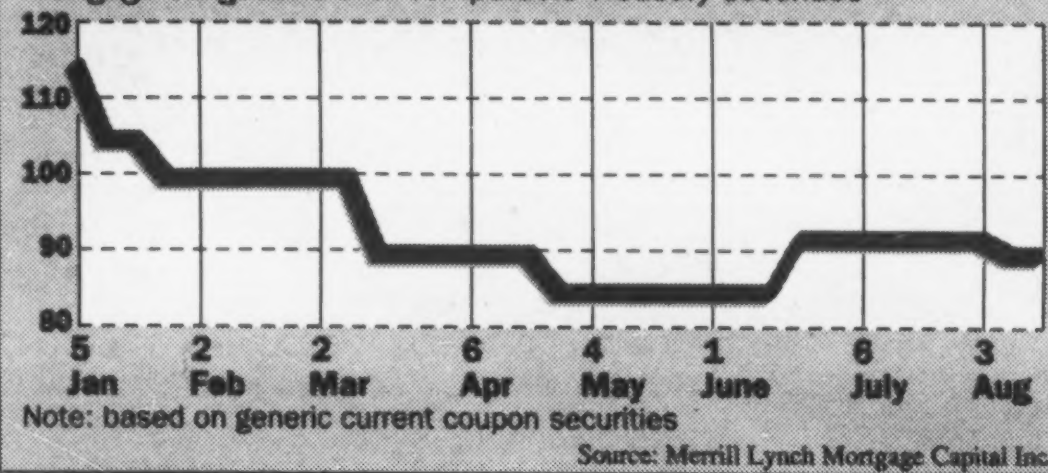
"We felt mortgage spreads were wide and wouldn't stay that wide for long, so we moved out of Treasuries and into CMOs," said Jeffrey D. Kelly, senior vice president of National City.

The FDIC data show that the top 100 banks held about \$25 billion of the most common types of CMOs as of March 31, representing about 18% of all securities held by the banks and 3% of their assets.

The FDIC data deal with

Spreads Tighten on CMOs

Estimated yield spread, in basis points, on three-year collateralized mortgage obligations over comparable Treasury securities



CMOs issued by the Federal National Mortgage Association and the Federal Home Loan Mortgage Corp., the dominant form of CMO.

The two secondary-market agencies say they had a total of \$125 billion of such securities outstanding as of March 31. Most of the securities are CMOs issued through real estate mortgage investment conduits.

While the FDIC had not collected CMO data before the first quarter, the Department of Housing and Urban Development has estimated that banks held only \$2.1 billion of Fannie Mae and Freddie Mac Remics as of December 1988. Such securities were nonexistent until August 1987, when Fannie Mae issued its first Remic.

Many of the top 100 banks in

the market also have substantial positions in basic mortgage-backed securities, known as pass-throughs. No. 1 ranked Pittsburgh National Bank, for example, holds about \$2 billion in CMOs and \$3.7 billion in pass-throughs as of March 31.

But some banks clearly prefer CMOs to the pass-throughs. No. 5-ranked First American National Bank, Nashville, Tenn., held \$883 million of CMOs as of March 31 but only \$174 million of pass-throughs, preferring the shorter maturities available in the CMO market.

The average estimated life of the bank's CMOs is about three years, said Howard Ragsdale, a senior vice president. "Pass-throughs would have 10- or 11-year average lives," he said. "We don't feel that banks should play in that market - it's just too much interest-rate risk."

To be sure, the average lives of short-term CMOs can increase significantly if interest rates rise. The degree of risk varies from CMO to CMO and can be extremely high with so-called companion bonds.

But Mr. Ragsdale reckons that First American's CMOs would see their average lives increase to only 3.2 years from the current 2.8 years if market rates rose by 300 basis points.

That is well within the limits with which regulators apparently are comfortable. The Office of the Comptroller of the Currency, in a proposed rule that was floated earlier this, suggested that if a 300 basis-point rate rise causes the securities' lives to lengthen by seven years or more, the securities are unsuitable for national banks.

Uncertainty caused by that proposal contributed to a decline in banks' appetites for

CMOs during the spring, dealers and bankers say. But a number of banks apparently have resumed their buying, albeit more cautiously. The OCC has yet to act on the proposal.

"There is less interest in volatile classes and more interest in more stable classes," said Mr. Overlander of Bear Stearns.

Of course, not all banks have been drawn to CMOs. For example, Signet Bank/Virginia, Richmond - a big player in the pass-through market - has generally steered clear of the CMO market.

The bank likes the higher yields found on pass-throughs and can absorb long-term assets, said Mike Flynn, a Signet vice president. He added that as the CMO market has become increasingly sophisticated, the securities have become "too esoteric to monitor" effectively.

For CMO fans, the most immediate concern is the decline in yields relative to Treasuries. Yields on traditional three-year classes have declined to 90 basis points over Treasuries from 115 basis points at the start of the year, according to Merrill.

The phenomenon stems in part from the weak housing markets, which has restrained the new supply of mortgages and basic mortgage-backed securities, analysts say.

Pittsburgh National, which built most of its industry-leading position in the second half of last year, has slowed its buying markedly this year, said Walter L. West, an executive vice president. He cited both a reduced need for assets and the tightening spreads.

"There isn't the opportunity to buy [CMOs] and match-fund them at spreads anywhere near as attractive as last year's," he said.

First Union Corp. also has pulled back in recent months, after increasing its position to about \$300 million during the second quarter. The Charlotte, N.C., company, did not rank in the top 100 on March 31, with holdings of less than \$60 million.

"We continually monitor the market and don't feel very good about it right now," said Ross Annable, a senior vice president at First Union. "We feel it might be a bit rich." □

NEWSMAKERS

George Bender Joins Ranieri's Battalion

By PHIL ROOSEVELT

George Bender knows what it's like to be Eisenhower's field general, George Patton - or Casey Stengel's slugger, Mickey Mantle.

He has just become Lewis S. Ranieri's mortgage-banking man.

United Savings Association of Texas, a Houston thrift led by Mr. Ranieri, last week named Mr. Bender executive vice president in charge of its burgeoning mortgage banking operations.

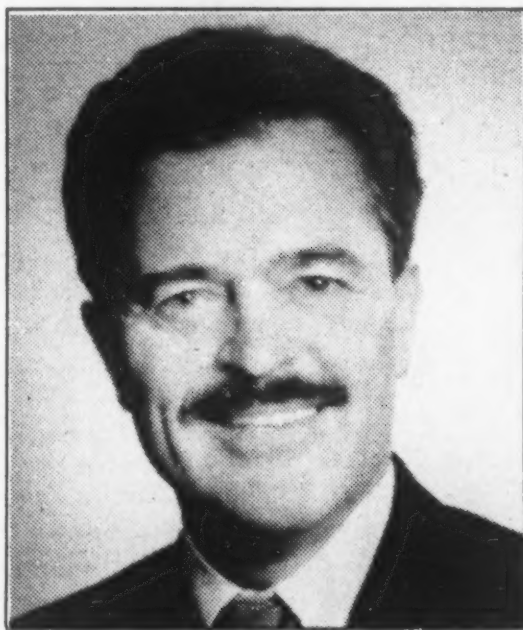
Mr. Bender - formerly head of CenTrust Bank's mortgage banking unit and a 28-year veteran of the industry - says he was eager to work with Mr. Ranieri, a former Salomon Brothers vice chairman who is considered the father of the mortgage-backed securities market.

'Good Combination'

"I bring specific mortgage banking knowledge, and he brings capital markets knowledge second to none - and that's a very good combination," Mr. Bender, 51, said in a phone interview from Houston.

United, which Mr. Ranieri purchased in a government-assisted deal in 1988, recently acquired a 15-state network of mortgage offices from Commonwealth Mortgage of America, Houston.

That gives United the capabil-



"I bring specific mortgage banking knowledge."

George Bender
United Savings Association

ity to originate an estimated \$3 billion of mortgages a year. It currently services about \$4 billion of loans for itself and for investors.

"George is a consummate production executive and a seasoned mortgage banking chief executive," said Walter C. Klein, chief executive of Sears Mortgage Co., Riverwoods, Ill. "I think he will be a formidable competitor for national originators, including Sears."

Mr. Bender said United plans

to add further to its branch system, especially in the Midwest, and to build a substantial correspondent network to get additional volume.

He expects the network to eventually include about 500 small and midsize mortgage brokers and mortgage bankers, with United underwriting the loans and closing most of them in its own name.

Mr. Bender had been with CenTrust Mortgage, Deerfield Beach, Fla., for five years, helping the company expand from 11 to 54 offices and markedly boosting profitability, according to United. But the parent, CenTrust Bank, was seized by the government earlier this year.

At CenTrust, Mr. Bender developed a correspondent network that "won kudos around the country," said Thomas La Malfa, research head at Asset-Backed Capital Corp., Cleveland.

Mr. Bender earned his mortgage banking stripes at Advance Mortgage Corp., Southfield, Mich., joining the company in 1962 and rising through the ranks during 15 years.

He went on to become senior vice president of United First Mortgage Corp., San Diego; chief executive of Unity Mortgage Corp., Chicago; and chief executive of West America Mortgage Co., Denver. □

Key Interest Rates

	Week ended 8/17/90	Week earlier 8/10/90	Year earlier 8/18/89
30-year fixed-rate mortgage	10.14	10.17	10.20
1-year adjustable-rate mortgage	8.17	8.21	8.65

Rates are based on a weekly survey of 2,000 lending institutions nationwide. The averages reflect rates for a range of loan sizes.
Source: HSH Associates, Butler, N.J.

Secondary Market

	Price 8/22	Week's change	Yield	Week's change	Treasury spread	Week's change
Ginnie Mae 9½%	97-27	-1-16	10.03	+0.28	+107	-3
Fannie Mae 9½%	97-30	-1-17	9.99	+0.32	+103	+1
Freddie Mac 9½%	99-24	0-26	10.00	+0.32	+104	+1

Yield: bond equivalent yield based on mortgage prepayment rates projected by Merrill Lynch. Treasury spread: the mortgage security yield minus yield on the current 10-year Treasury bond in basis points. (*) - Current coupon changed since last week.
Source: Merrill Lynch Mortgage Capital, New York

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